



Ministry Paper # 22

**MINISTRY OF FINANCE AND THE PUBLIC
SERVICE**

**DEBT
MANAGEMENT
STRATEGY**

FY 2008/09

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DEBT MANAGEMENT STRATEGY 2008/2009

INTRODUCTION

1. The *Debt Management Strategy* of the Government of Jamaica is an annual publication of the Ministry of Finance and the Public Service that provides information on the Government's debt management objectives, policies, plans and strategies for the fiscal year and the medium-term.

2. It provides a review of the developments and achievements during the previous year taking into account the composition of the debt portfolio, the fiscal operations, and developments in the macro-economy and in the domestic and international capital markets. The *Debt Management Strategy* is complemented by a chapter outlining details on Jamaica's public debt and debt developments during the preceding year in the annual Budget Memorandum also published by the Ministry of Finance and the Public Service.

3. The Government has benefited from the debt management strategies pursued over the past 10 years with progress achieved in the following areas:

- the lengthening of the maturity profile of both the external and domestic components of the debt,
- the using of the auction mechanism to issue securities;
- the broadening of market consultations with key players;
- the reducing of roll-over risk;
- the reducing of pricing risk;
- the minimising of cost in debt servicing;
- the increasing of investor confidence; and
- the minimising of foreign currency risk in the domestic debt portfolio

4. Over the years the Government has sought to:

- Maintain a prudent debt structure by:
 - having an appropriate mix of fixed-rate and floating-rate debt to further diversify and minimise interest-rate risk;
 - extending and smoothing the maturity profile of the debt to better manage refinancing risk; and
 - minimising foreign currency risk
- Further diversify the debt portfolio;
- Use market mechanisms for domestic debt issuances;
- Increase the transparency and predictability of primary market debt issuance; and
- Promote and build a liquid and efficient market for government securities.

5. The Strategy outlines the path to be pursued in managing the outstanding stock of debt while meeting the Government's financing needs at minimum cost and risk.

In FY2008/09 the Debt Management Strategy will continue to ensure that debt management policies and the operational framework are consistent with international best practices.

MARKET DEVELOPMENTS FY2007/08

6. The prevailing international and domestic economic conditions during FY2007/08 posed a challenge to the successful implementation of the strategy. The factors contributing to this included:
 - i. natural disasters;
 - ii. inflationary pressures and increasing interest rates;
 - iii. the requirements for additional financing to satisfy a higher than programmed fiscal deficit;
 - iv. increasing world oil and commodity prices; and
 - v. the sub-prime mortgage crisis in the United States leading to a credit crunch, and greater cautiousness by investors.

7. Despite the challenges the Government made marked achievements with:
 - i. the re-opening of the US\$350 million 8% Bond due 2039 issued in March 2007, for an additional US\$150 million thereby creating the first large and liquid bond with eligibility for the J.P. Morgan Emerging Market Bond Index + (EMBI+);
 - ii. the issuance of debt securities with twenty to thirty years tenure, that satisfied the segment of the market requiring long-term instruments;
 - iii. the reduction of the level of foreign exchange risk in the domestic debt portfolio; and
 - iv. the containment of the growth rate of the domestic debt.

8. Conversely, factors limiting further achievement of the strategy included:
 - i. increasing domestic market rates and market preference for variable rate securities at the shorter end of the curve; and
 - ii. the requirements for additional financing to satisfy a higher than programmed fiscal deficit.

9. During the fiscal year, Jamaica's credit ratings were reviewed by the international rating agencies Moody's Investors Service (Moody's), Fitch Ratings (Fitch) and Standard and Poor's (S&P). Moody's re-affirmed Jamaica's long-term foreign currency credit rating of "B1" and its long-term local currency rating of "Ba2", and maintained its "Stable" outlook. Fitch also reaffirmed Jamaica's foreign and local currency default rating of "B+" and maintained a "Stable" outlook. The ratings were supported by the country's political stability, the Government's willingness to pay its debts and its continued unwavering commitment to fiscal discipline despite exogenous shocks. S&P, in March 2008, conducted its annual due diligence meetings with key officials from the public and private sectors. The rating decision is expected during the first quarter of FY2008/09.

REVIEW OF FY2007/08

10. During FY2007/08 the *Debt Management Strategy* sought to:

- Reduce long-term financing costs and maintain a sustainable level of risk by use of liability management techniques;
- Maintain an appropriate mix of fixed-rate and floating-rate debt to further diversify and minimise interest-rate risk;
- Extend and smooth the maturity profile of the debt to better manage refinancing risk;
- Minimise foreign currency exposure of the domestic debt portfolio; and
- Increase the transparency and predictability of debt issuance.

11. At the end of March 2008, total public debt stood at \$1,000.7 billion. This represented an increase of 8.4 % over the stock of \$923.1 billion recorded at the end of March 2007. The Debt-to-GDP ratio stood at 126.1 % at the end of FY2007/08, compared with the 132.4% recorded at the end of FY2006/07 and the 134.8 % at the end of FY2005/06.

12. The stock of Central Government and Government Guaranteed external debt stood at \$438.6 billion (US\$6,169.3 million) at the end of March 2008. This represented an increase of 7.2 % compared with the stock of \$409.2 at the end of March 2007. In US\$ terms, the external debt rose by 2.2 % from US\$6,035.3 million at the end of March 2007. This was due to increases in both Central Government and Government Guaranteed debt. Central Government external debt increased from \$353.3 billion (US\$5,210.3 million) at the end of March 2007 by 5.3% to \$371.9 billion (US\$5,231.9 million) at the end of March 2008. The increase in Government Guaranteed external debt mainly reflected borrowings in support of Air Jamaica Limited. As a percentage of GDP, the external debt reflected a marginal decrease to 55.3% at the end of FY2007/08 compared with 58.7 % at the end of FY2006/07.

13. The stock of domestic debt at the end of March 2008 stood at \$562.1 billion. The debt stock increased by \$48.2 billion or 9.4% over that at the end of March 2007. The main factors contributing to the increase were a higher-than-programmed budget deficit, the issue of government securities to cover Bank of Jamaica (BOJ) losses, and the capitalisation of interest on previously issued securities to the BOJ.

14. The rate of growth of the domestic debt declined from 39.6% in FY2001/02 to 9.4% in FY2007/08 and the domestic Debt-to-GDP ratio declined from 79.0% in FY2001/02 to 70.8% in FY2007/08.

Liability Management

15. During FY2007/08 the Government examined portfolio liability management options as a strategic and effective tool for containing financing cost over the long-term and maintaining a sustainable level of risk. The options considered included:

- i. replacing short-term debt with long-term maturities;
- ii. prepayment of high-cost debt; and
- iii. replacing high-interest-rate debt with lower-interest-rate debt.

The results of this exercise have informed the current debt strategy.

Maintain an Appropriate Mix of Fixed-Rate and Floating-Rate Debt to Further Diversify and Minimise Interest-Rate Risk

16. Strong demand by investors for variable rate instruments at the short end of the yield curve countered the debt management objective of maintaining the desired mix of fixed-rate and floating-rate debt in the domestic debt portfolio. As a result of adverse interest rate movements, interest cost during the review period was greater than programmed and the portfolio was exposed to increased risk. Of the new domestic debt issued in FY2007/08, 34.1% was contracted on a fixed-rate basis and 65.9% on a variable-rate basis. This compared with a 28.3% fixed-rate and 71.4% variable-rate mix of the new debt issued in FY2006/07.

17. At the end of FY2007/08, the fixed-rate component of the domestic debt portfolio stood at 37.6% down from the 40.0% recorded at the end of FY2006/07. For the external debt portfolio, the share of fixed-rate debt continued to increase, reaching 81.2% at the end of FY2007/08, compared with 78.9% in FY2006/07.

Extend and Smooth the Maturity Profile of the Debt to Better Manage Refinancing Risk

18. During FY2007/08, consistent with the debt strategy objective of reducing refinancing risk over the medium-term, the Government was successful in maintaining the maturity structure of the external debt through the re-opening of the 32-year amortising 8% global bond in October 2007. The Government was however constrained in extending the maturity profile of the domestic debt as market appetite was skewed towards short-term maturities.

19. Despite market demand for shorter dated debt, the Government nevertheless successfully maintained the level of domestic debt securities with over 20 years maturity and issued 3.2% of new debt within this segment of the yield curve.

20. Domestic debt issues with maturities between 5 and 10 years declined to 28.6%, down from 29.9% in FY2006/07. In addition, of total debt issued, 63.4% would mature within 5 years, a significant increase when compared with 22.9% in FY2006/07 and 43.4% in FY2005/06. Within this period, 21.2% had maturities in the 1-3 years component of the debt structure and 32.4% in the 3-5 years segment.

21. Of the total domestic debt outstanding at the end of FY2007/08, 16.1 % had maturities of 10 years and over, a significant shift from the 44.3% at the end of FY2006/07 and 62.4% had maturities of up to 5 years, compared with 55.7% in

FY2006/07. Within the 1-5 year category, 16.6% is due to mature within a year, 31.4% in 1-3 years while 14.4 % will mature in 3-5 years.

Minimising Foreign Currency Exposure of the Domestic Debt Portfolio

22. The Government continued to make significant progress in reducing the foreign currency exposure of the domestic debt. At the end of FY2007/08, the overall foreign currency component of the domestic debt had declined to 12.2% from 14.5% at the end of FY2006/07 and 15.9% at the end of FY2005/06. US\$-indexed bonds totaled \$17.8 billion (US\$249.4 million equivalent) or 3.2% of the domestic debt portfolio at the end of FY2007/08, compared with \$24.6 billion (US\$362.2 million equivalent) or 4.8% at the end of FY2006/07. The stock of US\$-denominated bonds stood at \$49.8 billion (US\$701.0 million) or 8.9% of the domestic debt portfolio at the end of FY2007/08. This compared with \$50.0 (US\$736.8 million) or 9.7% of the domestic debt stock at the end of FY2006/07.

Increase the Use of the Auction System

23. The Government continued to use the multiple price auction system to re-price its benchmark 90-day and 180-day Treasury Bills, and to issue fixed rate securities across a range of maturities. Of a total of twenty-nine auctions with nominal value of \$16.8 billion conducted over the 12-month period, twenty-five were Treasury Bills and four were fixed-rate securities. This compared with a total of thirty auctions (twenty four Treasury Bills and six fixed-rate securities) with nominal value of \$18.05 billion held during FY2006/07.

24. A review of the systems to facilitate the re-opening of issues was conducted during the year.

Increase Transparency and Predictability

25. The Government remains resolute in its commitment to transparency and predictability in the execution of the debt strategy. During the year, the Government continued to publish comprehensive, timely and reliable information on the performance and management of the public debt, thereby ensuring greater predictability and accountability to the general public. The objective of maintaining transparency in debt issuance was achieved by the provision of up-to-date information to the market through regular updates to the Ministry's web site and public offerings to the investing community.

26. Comprehensive domestic and external debt data were published on the Ministry of Finance and the Public Service website (www.mof.gov.jm/dmu) on a monthly basis. During FY2007/08, the Government published on a monthly basis, schedules of upcoming market issues and the results of the issues. Information on the debt strategy, operations and key debt data including stock of debt, currency, interest and creditor

compositions, monthly interest rate schedules and relevant investor information were also made available on the Ministry's website.

Market Consultations

27. During FY2007/08, the Government continued its consultative approach with the markets. In February 2008, the Government conducted non-deal roadshows in Europe and the United States of America, when meetings were held with international investors and other key market participants to update them on the performance of the Jamaican economy and the medium-term outlook. Formal consultations and discussions between the public and private sectors in the domestic market continued in an effort to explore options for reducing the debt and debt servicing costs.

Domestic Capital Market Development

28. The Bank of Jamaica, as part of its mandate to reform the payments and securities settlement systems has assumed responsibility for the immobilisation of fixed-income securities. Immobilisation of Government securities will remove the need for the issuance of paper certificates. A provider has been identified and mandated to develop the system based on specifications.

Legal and Regulatory Framework

29. The proposed amendments to the statutes governing debt management were identified in conjunction with the Government's legal authorities and activities are continuing to update the relevant statutes. The annual review of the loan ceiling was completed. The loan ceiling is determined by the Loan Act, which gives authority to the Government for the amount of loans to be raised.

Government Borrowing FY2007/08

30. The borrowing requirement for FY2007/08 was projected at \$113.9 billion. Gross new debt issued during the fiscal year was \$121.7 billion. Among the purposes for which debt was issued were the Bank of Jamaica's losses and the capitalisation of interest on former FINSAC and other securities held by the BOJ in the amount of \$6,353.76 million.

DEBT STRATEGY FY2008/09

31. The objective of the Debt Management Strategy will continue to be:

“To raise adequate levels of financing on behalf of the Government of Jamaica at minimum costs, to develop and implement strategies to ensure the long-term sustainability of the public debt while maintaining risk at an acceptable level”.

32. Debt management in FY2008/09 will continue to focus on the strategic objective of the medium-term *Debt Management Strategy* of containment of the Government's exposure to risk within acceptable levels.

33. The *Debt Management Strategy* will:

- Address aspects of liability management;
- Increase the fixed-rate proportion of the domestic debt portfolio;
- Extend and smooth the maturity profile of the debt to better manage refinancing risk;
- Minimise foreign currency exposure of the domestic debt portfolio;
- Maintain the use of the auction mechanism for issuance of domestic securities;
- Increase the transparency and predictability of debt issuance and operations;
- Foster a more interactive relationship with the local and international markets;
- Engage the multilateral institutions to seek more cost effective borrowing; and
- Issue debt in the external markets equivalent to the level of external amortization.

Liability Management

34. Market conditions permitting the Strategy will seek to reduce the interest cost of the debt portfolio by either, or a combination of:

- i. replacing short-term debt with long-term maturities;
- ii. prepayment of high-cost debt; and
- iii. replacing high-interest-rate debt with lower-interest-rate debt

Increase the Fixed Rate Proportion of the Domestic Debt Portfolio

35. The Strategy will seek to increase the fixed rate portion of the domestic debt to at least 40% taking advantage of any favourable interest rate environment that may obtain. This will protect the portfolio from interest rate volatility and increase the predictability of debt service costs.

Extend and Smooth the Maturity Profile of the Debt to Better Manage Refinancing Risk

36. The strategy in FY2008/09, market conditions permitting, will continue to offer government securities with maturities of 10 years and over. The Government will seek to issue at least 50% of its debt with maturities in excess of five years and maintain the proportion of 3-4 % with maturities of twenty years and over in the domestic market. This will facilitate the development of the long end of the yield curve with the objective

of reducing refinancing risk over the medium-term. The issuance of these securities will provide investment solutions to investors who require long-term instruments to support their asset /liability needs.

Minimise Foreign Currency Exposure of the Domestic Debt Portfolio

37. Focus on reducing the foreign currency exposure of the domestic debt portfolio will continue. The foreign currency component will be reduced to below 10%. Foreign currency risk will be further reduced through limitation on the use of U\$-denominated and U\$-indexed instruments in the domestic market.

Maintain the Use of the Auction System

38. Use of the auction mechanism to promote competitiveness through the bidding process for efficient market determined pricing will be maintained.

39. Auctions will be conducted on a regular basis with issues across a wide range of maturities. During this financial year review of the systems will be finalised to facilitate reopening of existing issues through a central securities depository.

Increase the Transparency and Predictability of Debt Issuance and Operations

40. Increased transparency and predictability have played and will continue to play a key role in guiding the issuance strategy. Its approach to risk, relative costs, market conditions and opportunities, the size of maturing securities and the maturity profile of the existing stock of debt will determine funding sources and instrument types. These are all consistent with efforts to maintain a prudent debt structure.

41. Securities will be offered in the domestic market on a monthly and pre-announced basis. While the Government remains committed to the use of market mechanisms for the issuance of securities, it will be flexible in terms of the options used to meet the budgetary requirements and debt management objectives.

42. Transparency in the Government's debt operations and borrowing programme will be facilitated through:

- Monthly publications of comprehensive external and domestic debt data;
- Advance notices of upcoming debt issues;
- Monthly offerings of securities through a competitive process;
- Annual schedule of Treasury Bill Tenders;
- Monthly schedules of market issues by the end of the preceding month;
- Dissemination of the terms and conditions of instruments to the market at least three business days prior to the subscription days;
- Timely publication of the results of market issues; and
- Quarterly reports on debt related developments by the end of the month following the quarter.

43. These, along with the *Debt Management Strategy* and relevant investor information, will continue to be made available in the print media and electronically on the Ministry's website (www.mof.gov.jm/dmu).

Foster a More Interactive Relationship with the Markets

44. The Strategy will include the hosting of quarterly meetings with the domestic market makers and quarterly investors' conference calls with the international capital markets and conduct investor presentations and road shows in North America and Europe. This approach will provide information on, and foster greater awareness and transparency of, debt operations and debt management objectives.

Engage the Multilateral Institutions to Seek More Cost Effective Borrowing

45. The Government will continue discussions with the multilateral institutions and their affiliates to secure longer tenure and more cost effective financing for infrastructural developments and budgetary requirements.

Institutional Strengthening Framework

46. The Government will continue to facilitate the development of a modern and efficient domestic capital market. A review of the supporting systems and infrastructure will be done. A Central Securities Depository will be implemented and this will facilitate commencement of the immobilisation of securities during the year with a view to issuing securities in a dematerialised form only. Dematerialization is the issuance and recording of securities in electronic format. This will result in savings for the Government and other stakeholders.

47. A series of public education programmes on the immobilisation of securities will be conducted to inform the investing public. The Central Securities Depository will allow for the further development of the domestic capital market by increasing efficiency and reducing risks. It will also provide real time information on secondary market activities while facilitating speed in trading and settlement of securities on a secure platform.

Update the Legal and Regulatory Framework

48. The relevant statutes will be amended to facilitate the immobilisation and dematerialisation of Government securities. Steps will be taken to streamline and modernise the applicable loan legislation.

49. Consistent with the Government's commitment to annually review the amount of loans raised under the Loan Act vis-à-vis the loan ceiling, steps will be taken to increase the loan ceiling pursuant to the medium-term borrowing programme.

GOVERNMENT BORROWING REQUIREMENTS FY2008/09

50. Gross issuance in FY2008/09 is programmed to be higher than in FY2007/08. The budgetary financing requirement is projected at \$183.5 billion. In keeping with the Strategy the Government will seek to access externally an amount equivalent to the level of amortisation of the external debt. The remainder of the required financing will be raised in the domestic market. Disbursements on project-related loans are estimated at US\$125 million in FY2008/09.

51. In light of the outlook for the macroeconomic fundamentals and the continued prudent and effective borrowing programme, the Debt-to-GDP ratio is projected to continue the declining trend in FY2008/09.

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